

## Agricultural Bank of China (ABC) [1288.HK]

Net Profit grew by 7.9% with above-average NIM; Maintain BUY

Agricultural Bank of China (ABC) [1288.HK] reported net profit of RMB179,461m for 2014, up 7.9% year-on year (YoY), lower than market consensus (10.42%) and our forecast (12.96%) mainly due to the lower growth of non-interest income (actual: 5.21% vs expected: 11.87%) and higher non-performing loans (NPLs) (NPL ratio jumped to 1.54% from 1.22%). Formed from the merger of the Farmers Bank of China and the Cooperation Bank, ABC enjoys a relatively low-cost rural funding network, driving its above-average net interest margin (NIM 2.92% vs sector average 2.70%), and in current conditions relatively high NPL ratio (1.54% vs sector average 1.25%). On balance, the net effect is positive for ABC, as seen in its relatively high impairment provision ratio (4.42% vs. sector average 2.90%) which gives a comfortable buffer. We trim our net profit growth for 2015E from 13.1% to 7.4% mainly due to faster interest rate liberalization process. Maintain **BUY** with a target price of **HK\$4.78**.

- 2014 results highlights:** Net profit grew by 7.9% from RMB166,211m to RMB 179,510m, lower than market consensus and our own forecast. Net interest income increased by 14.27% (in line with our expectation 14.89%) from RMB376,202m to RMB429,891m. Net fee and commission income drop 3.8% to 80,123m mainly due to the Measures for the Administration of the Service Prices of Commercial Banks issued by CBRC in August (The new measures requires banks to lower or even cancel the fees from inter-bank transfer, account management and remote withdrawals). The bank also had to spend more on allowance for impairment losses as NPL ratio soar to 1.54%. Tier 1 CAR and CAR increased to 9.46% and 12.82% because of the issuance of preference shares and slightly lower dividend payout ratio (dropped from around 35% to around 33%).
- NIM among the highest, but it may face pressure from interest rate liberalization process:** ABC's costs of funding (1.85%) was among the lowest because of its unique characteristic, and also enjoyed larger net interest income from interbank business, thanks to its liquid balance sheet (loan-deposits ratio: 64.61% vs sector average 71.8% based on old measures). However, as full interest rate liberalization may come at the end of 2015, we believe ABC's NIM will face some pressure to shrink.
- Although NPL ratio is high, we still believe ABC has well prepared for credit deterioration; and considering trough valuation; Maintain BUY.** Although NPL ratio increased to 1.54% as the credit quality worsened in retail/wholesale sector (3.69%) and manufacturing sector (NPL 5.93%) (accounted for 80% of total NPLs size), we think the worst is over considering the government will keep injecting liquidity into the market and there will likely be more cut on interest rate to ease the burden on borrowers. We also believe the bank is well prepared for the current credit environment with its conservative provision ratio (4.42% vs average 2.90%). Management mentioned the exposure to local government debts was RMB333.5bn (4% of total loans), the NPL ratio of it was 0.2% covering by 20x allowance which fully covered the risks. ABC is currently trading at 5.1x/0.8x 2015E PER/PBR, maintain **BUY** with TP **HK\$ 4.78**.

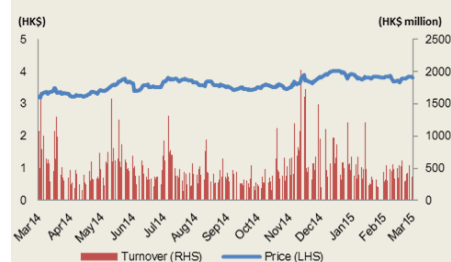
### China Banking Sector

# BUY

Close: HK\$3.80 (Mar 24th, 2015)

Target Price: HK\$4.78 (+25.2%)

#### Price Performance



Market Cap	US\$159,221m
Shares Outstanding	324,794m
Auditor	PwC
Free Float (H-share)	17.1%
52W range	HK\$2.697-4.10
3M average daily T/O	US\$74m
	Central Huijin 40.3%
Major Shareholder	Ministry of Fin. 39.2%

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Figure 1: Key Financials

Key Financials	2011	2012	2013	2014	2015E	2016E
Net interest income (RMBm)	307,199	341,879	376,202	429,891	455,942	469,971
- Change (%)	26.86%	11.29%	10.04%	14.27%	6.06%	3.08%
Non interest income (RMBm)	72,557	83,085	89,569	94,235	100,780	107,856
- Change (%)	44.82%	14.51%	7.80%	5.21%	6.95%	7.02%
Net Profit (RMBm)	121,956	145,094	166,315	179,461	192,810	201,462
- Change (%)	28.50%	18.97%	14.63%	7.90%	7.44%	4.49%
NPL ratio (%)	1.55%	1.33%	1.22%	1.54%	1.38%	1.20%
Net Interest Margins (%)	2.85%	2.81%	2.79%	2.92%	2.75%	2.55%
PER (x)	8.0	6.8	6.0	5.5	5.1	4.9
PBR (x)	1.5	1.3	1.2	1.0	0.8	0.6
ROE (%)	20.46%	20.74%	20.89%	19.57%	16.53%	13.88%
ROA (%)	1.11%	1.16%	1.20%	1.18%	1.14%	1.10%
DY (%)	4.36%	5.16%	5.87%	5.97%	6.42%	6.71%

Source: Company, CGIHK Research

**Figure 2: Income Statement & Balance Sheet**

(Unit: Millions of RMB)	2012	2013	2014	2015E	2016E
<b>Income statement</b>					
Interest income	566,063	613,384	699,289	748,239	785,651
Interest expense	-224,184	-237,182	-269,398	-292,297	-315,681
<b>Net interest income</b>	<b>341,879</b>	<b>376,202</b>	<b>429,891</b>	<b>455,942</b>	<b>469,971</b>
Fee and commission income	78,573	89,697	87,883	92,277	97,814
Fee and commission expense	-3,729	-6,526	-7,760	-8,652	-9,604
<b>Net fee and commission income</b>	<b>74,844</b>	<b>83,171</b>	<b>80,123</b>	<b>83,625</b>	<b>88,210</b>
Net trading gain/loss	3,070	2,360	1,908	2,200	2,300
Net gain/loss on financial instruments designated as at fair value through profit or loss	-309	-989	1,840	2,000	1,800
Other operating income, net	5,480	5,027	10,364	12,955	15,546
<b>Operating income</b>	<b>424,964</b>	<b>465,771</b>	<b>524,126</b>	<b>556,722</b>	<b>577,826</b>
Operating expenses and loss	(237,037)	(251,597)	(291,869)	(307,867)	(317,804)
<b>Profit before tax</b>	<b>187,927</b>	<b>214,174</b>	<b>232,257</b>	<b>248,855</b>	<b>260,022</b>
Income tax expense	(42,796)	(47,963)	(52,747)	(55,992)	(58,505)
<b>Net profit attributed to shareholders</b>	<b>145,094</b>	<b>166,315</b>	<b>179,461</b>	<b>192,810</b>	<b>201,462</b>
<b>Non-controlling interests</b>	<b>37</b>	<b>-104</b>	<b>49</b>	<b>52</b>	<b>55</b>
<b>Earnings per share (in RMB)</b>	<b>0.45</b>	<b>0.51</b>	<b>0.55</b>	<b>0.59</b>	<b>0.62</b>

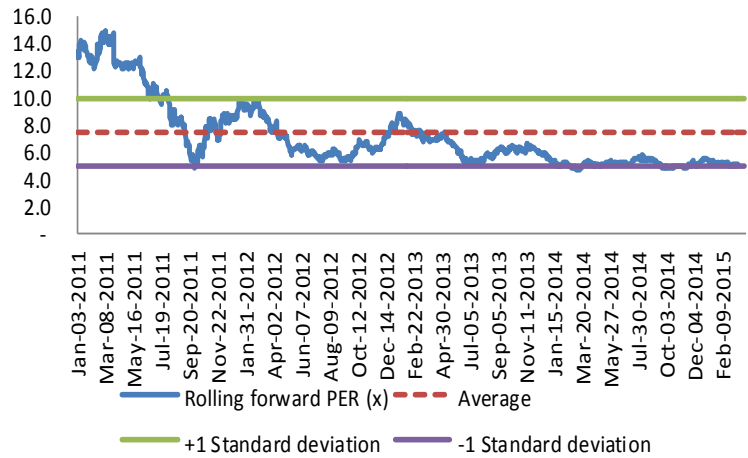
(%)	2012	2013	2014	2015E	2016E
<b>Key Ratios</b>					
P/B:	1.31	1.18	0.96	0.76	0.62
P/E:	6.78	5.98	5.52	5.14	4.92
Loan-to-deposit Ratio:	59.22%	61.17%	64.61%	66.36%	68.36%
Net interest income growth:	11.29%	10.04%	14.27%	6.06%	3.08%
Non interest income growth:	14.51%	7.80%	5.21%	6.95%	7.02%
Profit Growth:	18.97%	14.63%	7.90%	7.44%	4.49%
NPL Ratios:	1.33%	1.22%	1.54%	1.38%	1.20%
Interest Margin:	2.81%	2.79%	2.92%	2.75%	2.55%

(RMB m)	2011	2012	2013	2014	2015E	2016E
<b>Balance sheet</b>						
<b>Assets:</b>						
Cash and deposits with central bank	2,487,082	2,613,111	2,603,802	2,743,065	2,745,808	2,759,537
Due from banks and non-bank financial institutions	873,997	1,300,233	1,443,385	1,489,285	1,682,892	1,817,523
Loans and advances to customers	5,398,863	6,153,411	6,902,522	7,739,996	8,746,195	9,550,845
Financial investments	2,636,576	2,860,973	3,228,284	3,582,825	3,941,108	4,216,985
Property and equipment	131,815	141,490	150,859	154,950	156,500	159,629
Deferred tax assets	45,698	56,949	74,075	78,640	102,232	132,902
Other assets	103,546	118,175	159,175	185,391	329,775	395,730
<b>Total assets</b>	<b>11,677,577</b>	<b>13,244,342</b>	<b>14,562,102</b>	<b>15,974,152</b>	<b>17,704,509</b>	<b>19,033,152</b>
<b>Liabilities</b>						
Due to central banks	50	66	104	80,121	104,157	113,011
Derivative financial liabilities	218,694	164,259	313,894	379,733	436,693	480,362
Due to banks and non-bank financial institutions	816,315	941,704	930,504	1,187,085	1,246,439	1,308,761
Due to customers	9,622,026	10,862,935	11,811,411	12,533,397	13,786,737	14,613,941
Deferred tax liabilities	27	15	8	43	45	45
Bonds payable	119,390	192,639	266,261	325,167	351,180	386,298
Other liabilities	251,287	331,370	395,383	435,987	479,586	527,544
<b>Total liabilities</b>	<b>11,027,789</b>	<b>12,492,988</b>	<b>13,717,565</b>	<b>14,941,533</b>	<b>16,404,837</b>	<b>17,429,963</b>
<b>Equity:</b>						
Share capital	324,794	324,794	324,794	364,738	404,794	404,794
Reserves and retained profits	324,807	425,021	518,314	666,328	893,278	1,197,011
Non-controlling interests	187	1,539	1,429	1,553	1,600	1,600
<b>Total equity</b>	<b>649,788</b>	<b>751,354</b>	<b>844,537</b>	<b>1,032,619</b>	<b>1,299,672</b>	<b>1,603,405</b>
<b>Total liabilities and equity</b>	<b>11,677,577</b>	<b>13,244,342</b>	<b>14,562,102</b>	<b>15,974,152</b>	<b>17,704,509</b>	<b>19,033,368</b>

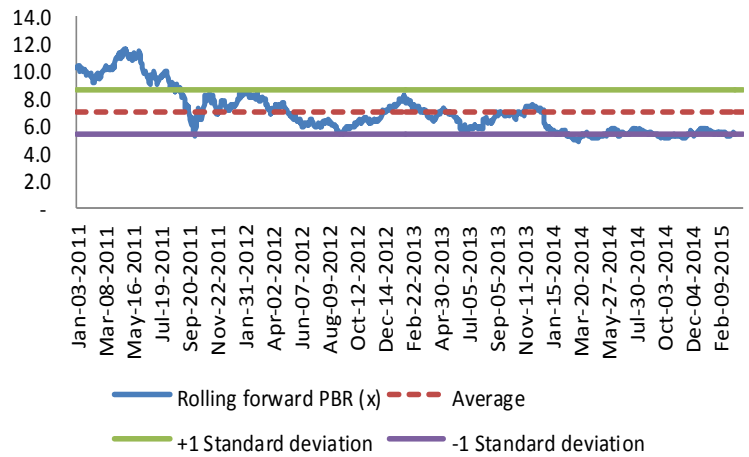
Source: Company, CGIHK Research

**Figure 3: PER**



**ABC at around the lowest valuation since IPO in 2010...**

**Figure 4: PBR**



Source: Company, CAP IQ, CGIHK Research

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BUY : share price will increase by >20% within 12 months in absolute terms

SELL : share price will decrease by >20% within 12 months in absolute terms

HOLD : no clear catalyst, and downgraded from BUY pending clearer signal to reinstate BUY or further downgrade to outright SELL

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